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The Conceptual Underpinnings of International Public Sector Accounting

Sheila Ellwood (Bristol University) and Sue Newberry (Sydney University)

Ellwood and Newberry (2006) argued that a common conceptual framework across the commercial and public sector was a 'bridge too far', but the current trend appears to be for governments to follow International Public sector Accounting Standards (IPSAS) which are based on International Financial Reporting Standards (IFRS).

The International Accounting Standard Board's (IASB) conceptual framework first introduced in 1989 has been under revision for several years: firstly as part of a joint project with the US Financial Accounting Standards Board (FASB) and then since 2012 on its own. Since 2010, the IASB's conceptual framework has identified a single objective of financial reporting as serving the business financier in capital markets (IASB 2010).

The IPSASB which commenced its standard setting programme on the premise of minimum deviation from IFRS, issued its own conceptual framework in 2014, with objectives that differ from that of the IASB (IPSASB, 2014). The conceptual underpinnings of these frameworks are potentially very important for the future of public sector accounting internationally, and here we comment on the implications for public sector accounting.

While there seems to be general agreement that governments should adopt accrual accounting supported by appropriate accounting standards, there has been a long-running debate over whether one set of standards (the IASB's) should be applied to businesses and governments alike, or whether separate standards should be promulgated for each sector. This has resulted in mixed practices.

Australia and New Zealand, after many years of applying common standards (called 'sector neutral' standards), in 2002 when they decided to adopt International Financial Reporting Standards (IFRS) agreed that IFRS would apply to both the business and the public sectors. Recently, however, New Zealand has moved to International Public Sector Accounting Standards (IPSAS), following the Auditor General's criticism of the modifications to IFRS for public sector purposes (Auditor General, 2009, see also Cordery and Simpkins, 2016). Australia and the UK have steadfastly adhered to IFRS modified as necessary for a public sector context. Spain is one of the few continental European countries formally adopting IPSAS, but others are moving to IPSAS (most notably Greece.) Further countries use them as a reference as does the EU in developing European Public Sector Accounting Standards (EPSAS) for EU member states. Several developing countries, following World Bank or IMF requirements, are also adopting IPSAS.

Conceptual Frameworks

FASB (1978, p. 2) defines a conceptual framework for accounting as:

A constitution, a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and financial statements.

While such a theoretical framework may suggest that accounting standard setting is a technical activity, it represents instead an intermingling of the technical and political (Gaa, 1988). The IPSASB

sees its *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* as establishing 'the concepts that underpin financial reporting by public sector entities that adopt the accrual basis of accounting' (IPSASB, 2014 p.9). The framework attempts to provide a common frame of reference for the IPSASB when developing new standards and for preparers and others in dealing with financial reporting issues (IPSASB 2014 p.11). This view of conceptual frameworks as providing a theoretical underpinning has been questioned. In the USA, Dopuch and Sunder (1980) argued that conceptual frameworks serve to improve the legitimacy of the standard setter and the relationship to specific standards will be vague. In the UK, Page and Spira (1999) argue that conceptual frameworks are the 'conceptual underwear' of accounting and use the metaphor to explain its dual purpose -to support or to make standard setting look good? More recently, in the context of the IFRS framework, Brouwer et al. (2015) argue there are many inconsistencies between the framework and the standards relating to assets and liabilities, for example, standards for leasing and deferred tax. These comments illustrate Gaas' (1988) point that a conceptual framework's abstract foundations can be used to support multiple solutions to any policy issue, while at the same time those foundations are unlikely to provide a sufficient and compelling basis for any particular decision (Gaa, 1988).

The question here is whether the IPSASB Framework will provide a satisfactory underpinning for public sector accounting internationally.

Differences between sectors

Many writers (e.g. Barton, 2005; Biondi, 2012) have argued the differences between the sectors and how these differences require a distinct approach to accounting. Both the US Governmental Accounting Standards Board's (GASB) (GASB, 2013) and the IPSASB (2014) frameworks set out the main environmental differences: organisational purposes; sources of revenue; potential for longevity; relationship with stakeholders; and the important role of the budget. However, only the GASB document goes on to explain how the differences relate to standards (on capital assets, pensions etc.). Research and discussion has focused on whether business style accrual accounting fits the public sector rather than on analysing which alternative options of accrual accounting¹ best serve the needs of public sector stakeholders (Oulasvirta, 2014).

The objectives of financial reporting

The IASB conceptual framework (2010) identifies the primary users to whom general purpose financial reports (GPFs) are directed as 'existing and potential investors, lenders and other creditors'. The objective of financial reporting is-

'to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying and selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.'

¹ For example, a revenue/expense accounting approach instead of the asset/liability and fair value approach of IFRS.

These users and objectives² are very different from those traditionally envisaged for public sector accounting (Drebin, 1981). The IPSASB (2014) acknowledges this divergence and sets out markedly different objectives and users-

'The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFs for accountability purposes and for decision-making purpose.' (2.1).

The primary users are 'service users and their representatives and resources providers and their representatives' (s2.4 to 2.6). Although the IPSASB framework sets out distinct public sector objectives and primary users it is less traditionally public sector focused than GASB (2013) which places accountability to citizens foremost³.

Accountability and decision usefulness

The GASB does acknowledge that accountability information, while meeting the citizenry's 'right to know' can be used to support decision making. The IPSASB sees its conceptual framework as serving both accountability and decision usefulness at the same time and, similar to the GASB, suggests that the accountability information can also be used for decision making (para 2.35). Some doubt whether this would be possible working from the IASB's increasingly specific decision-usefulness approach (for example Laughlin 2008; 2012; Whittington, 2008).

A general purpose financial reporting model predicated on 'decision usefulness' is essentially a market-based model that assumes making rational decisions facilitated by the availability of appropriate information will result in the efficient allocation of resources (Mack and Ryan, 2006). However, as the focus on decision useful information becomes increasingly specific in the standards, whether the financial reports can still be called general purpose is arguable, and the potential for such reports to also serve accountability purposes is lost (Laughlin, 2008). Whittington (2008) outlined and illustrated how the IASB's increased emphasis on specific decision useful information would prevent the use of financial reports for accountability purposes.

A danger in this debate over accountability and decision usefulness is that much of it is conducted in general terms without clarity as to the meanings to be attributed to these terms. Both Laughlin (2008) and Whittington (2008) sought to clarify, and Laughlin (2012) urged the IPSASB for clarity about its accountability objective. Perhaps muddying the waters even more, the IASB has recently re-introduced accountability into its mission statement (and proposed introduction into its conceptual framework), but its new interpretation of accountability is so narrow it can only obscure the debate about appropriate objectives for general purpose financial reporting (Newberry, 2015). Additionally, the IASB's interpretation of the term "public accountability" is contrary to the norms of

² The 2015 Exposure Draft proposes adding stewardship into the objective (from an investor, lender, creditor perspective).

³ GASB (2013) couches the issue in terms of user needs 'the needs of the citizens and oversight organizations emphasise accountability for resources entrusted to the government while the needs of equity investors emphasize information necessary to make rational investment...decisions' (p2). It does acknowledge that accountability information while meeting the citizenry's 'right to know' can be used to support decision making.

democratic accountability traditionally required in public sector accounting (Newberry, 2015)⁴.

The CF should permeate through to standards and their application

IFRS is designed for profit-making bodies and the IASB's standards are increasingly developed to support specific decision usefulness needs, thus "stretching GPFERS to the extremes of general relevance" (Laughlin, 2008, p.251). Currently, IPSAS are based on IFRS. Many standards were issued under both IAS/IFRS and IPSAS before respective frameworks were in place and there are inconsistencies between standards and the frameworks (Brouwer *et al.*, 2015). The IPSASB does now recognize different purposes and users of general purpose financial reports from those of the IASB, but it is not clear how these translate into different standards, particularly for similar transactions though (in line with the subsequently stated objectives and user needs) theoretically they should. Ironically, the UK is often claimed to be closest to IPSAS as it follows IFRS on which IPSAS are based (Ernst and Young, 2012).

The differing conceptual frameworks do not seem to be reflected in standards. For example, it is often argued that if IPSAS or IFRS were followed, the market value of structured loans would be substituted for nominal value and this would be more appropriate—but would it? There needs to be agreement on the purpose of financial reporting and who the users are. Proponents of IPSAS (for example Ball 2015) have claimed that through following IFRS, it provides the most appropriate treatment for measuring government debt. However, Calmel (2014) argues the objective is not to provide users with information about the market value of structured loans as required under IPSAS and IFRS but to make an estimate of the financial risk according to market conditions at the inception of the loan (unrealized gains and losses are not relevant). If there is no common understanding, the consequences can harm transparency and accountability.

Harmonisation or standardisation

Roberts et al (1998) define harmonisation as a process by which accounting moves from total diversity of practice whereas standardisation is a process whereby participants agree to follow the same accounting practices. IPSAS has led to a degree of harmonisation among western countries and some standardisation is expected in developing countries (PwC, 2013). Within the EU, Mussari (2014) claims that unification of the accounting of member states is the ultimate aim of the EPSAS

⁴ The IASB interprets "accountability" as "reducing the information gap between providers of capital and the people to whom they have entrusted their money", this interpretation replacing the previous explanation that accountability expectations required portraying the financial effects of past events. The IASB interprets "public accountability" as existing for those entities with debt or equity instruments traded in a public capital market, or, as one of its primary businesses, holding assets in a fiduciary capacity for a broad group of outsiders (see Newberry, 2015 for more detailed explanation),

project. Unification is an extreme form of standardization which he argues would apply to all public sector organisations within a geographical area.

‘Basically, this means not only common budget and financial statements formats as well as identical accounting standards but also a single chart of accounts, as well as identical accounting rules, in short, accounting normalization.’ Mussari 2014 p.307.

The financial institutions require a specific (standardised) way of looking at national deficits and debt which can be achieved through statistical reporting though a grand convergence of statistical, budgeting and financial reporting systems is sought (IMF, 2012; Heiling et al, 2013). However, as Jones and Caruana (2014) argue, if macro-level surveillance determines accrual accounting then the micro-level benefits (from developing a conceptual framework with accountability objectives for financial reporting) may be lost.

Conceptual underpinnings are (or at least should be) important

IPSAS are playing an increasing role in public sector accounting internationally. Establishing a conceptual framework that distinguishes objectives and users for public sector financial reporting from those of IFRS is important, and a positive step. Public sector accounting serves different purposes than business accounting and this necessarily affects the accounting. The IPSASB initially sought to follow IFRS with minimal deviation and therefore there is a danger the existing standards may not have been derived with sufficient focus on public sector accountability requirements. This implies change to many of those standards. How the conceptual framework affects standards in the future will indicate whether the framework is functioning as a conceptual underpinning or is more cosmetic.

IPSAS adoption and development is currently heavily influenced by global financial institutions which may also distort public sector accounting from public service values. Accounting is not an end in itself (Burchell *et al.*, 1980) the purpose set out in a framework and adherence to purpose is crucial in achieving an appropriate accounting system. Accounting is not merely a technical tool, how systems are constructed can have consequences (Hines, 1988; Ellwood and Garcia-Lacalle, 2012), nor is it a neutral tool (Gaa, 1988). The IPSASB framework has set out ambitious aims to serve the needs of service users and their representatives. How this will be achieved through existing and future IPSAS will provide ongoing challenges for the IPSASB and remain a topic of considerable research interest.

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